

Internal Revenue Service
memorandum

CC:INTL:FO
KAPalmerino

date: JUN 28 1990

to: [REDACTED]

Team Chief, Appeals, [REDACTED]

from: Kim A. Palmerino *KAP/bdb*
Special Counsel, International CC:INTL

subject: [REDACTED]

Your question was whether \$ [REDACTED] of excess offsets under I.R.C. 482 for the FYE [REDACTED] should be allowed as an offset for FYE [REDACTED].

The facts, as I understand them are as follows:

For its FYE [REDACTED] (a [REDACTED] domestic subsidiary) overcharged a related controlled foreign corporation ([REDACTED]) for charter hires in an amount in excess of \$ [REDACTED]. [REDACTED] wants to utilize the remaining amount to offset other 482 adjustments for its FYE [REDACTED].

For its FYE [REDACTED], [REDACTED] overcharged [REDACTED] for charter hires in the amount of \$ [REDACTED].

By letters dated [REDACTED] and [REDACTED], [REDACTED] made demand from [REDACTED] to adjust and credit the overcharges for the FYE [REDACTED]. The overcharges for FYE [REDACTED] have been repaid by [REDACTED] and are not at issue.

In the [REDACTED] and [REDACTED] letters, [REDACTED] stated the demand for correction of the overcharges for the FYE [REDACTED] did not constitute a waiver of any rights of [REDACTED] against [REDACTED] on account of overcharges for charter hires which may have resulted in years prior to [REDACTED].

The [REDACTED] and [REDACTED] years were audited during [REDACTED] at the same time. On [REDACTED] [REDACTED] filed claim for the [REDACTED] setoff in accordance with Rev. Proc. 70-8, 1970-1 C.B. 434 but did not file a claim for the FYE [REDACTED] setoff. A substantial portion of the FYE [REDACTED] setoff was utilized in the FYE [REDACTED]. With respect to the FYE [REDACTED], no thirty day letter was issued because [REDACTED] demanded a statutory notice be issued. A statutory notice was issued on [REDACTED] because [REDACTED] refused to extend the statute.

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██████████ contends that the ██████████ and ██████████ letters established the existence of an implied arrangement during the FYE ██████████ which provided for repayment (equivalent to setoff) of previous overcharges that would offset current (FYE ██████████) undercharges.

Pursuant to Rev. Proc. 70-8 and Treas. Reg. Sec.1.482-1(d)(3), ██████████ contends the ██████████ excess offsets should reduce the IRC Sec.482 adjustments (arising out of other transactions) for its FYE ██████████.

Treasury Reg. Sec.1.482-1(d)(3) provides:
In making distributions apportionments or allocations between two members of a group of controlled entities with respect to particular transactions, the district director shall consider the effect upon such members of an arrangement between them for reimbursement within a reasonable period before or after the taxable year if the taxpayer can establish that such an arrangement in fact existed during the taxable year under consideration. The district director shall also consider the effect of any other non-arm's length transaction between them in the taxable year which, if taken into account would result in a setoff against any allocation which would otherwise be made.....

In order to establish that a setoff to the adjustments proposed by the district director is appropriate, the taxpayer must notify the district director of the basis of any claimed setoff at anytime before the expiration of the period ending 30 days after the date of a letter by which the district director transmits an examination report notifying the taxpayer of proposed adjustments.....

Section 1.03 of Rev.Proc. 70-8 provides that the requirement that the taxpayer notify the district director of the basis of any claimed setoff is separate and distinct from the requirements that the taxpayer establish that such an arrangement (an arrangement for reimbursement) in fact existed.

Section 3.02 of Rev.Proc. 70-8 provides the notification to the district director must sufficiently identify the arrangement for reimbursement upon which the claimed setoff is based so as to constitute a reasonable foundation for the claimed setoff and permit verification by the Service.

Section 3.08 of Rev.Proc. 70-8 provides that information necessary to establish the claimed setoff must establish that an arrangement did in fact exist during the taxable year under consideration.

In a memorandum to you dated March 15, 1988, [REDACTED] International Litigation Counsel addressed the issue of whether [REDACTED] could raise the setoff for [REDACTED] on [REDACTED] more than two years after the issuance of the statutory notice. His response, in part, provided:

The two-year delay by the taxpayer in this case is outside any reasonable period for raising the setoff issue. Tres. Reg. Section 601.105(f) recognizes that due to the eminent running of the statute of limitations the district director may have to issue the statutory notice. We assume the taxpayer here refused to sign a consent extending the statute of limitations and therefore the notice was issued without a prior thirty-day letter. The taxpayer should, however, have had time to raise setoff issues during the examination or early after the petition was filed and referred to the Appeals Division. The taxpayer could also have extended the statute of limitations giving time for the presentation of notice and explanation of his setoff.

We note that in two cases where taxpayers raised the setoff argument, although the court considered and rejected on the merits their proposed setoffs, the taxpayers were admonished for not following the notice and time requirements of Treas. Reg. § 1.482-1(d)(3). See, Liberty Loan Corporation v. United States, 498 F.2d 225, 231 (8th Cir. 1974), cert. denied, 419 U.S. 1089 (1974); Lathen Park Manor v. Commissioner, 69 T.C. 199, 217-18 (1977); see also, Sunshine Department Stores, Inc. v. Commissioner, T.C.M. 1981-586 [no mention-of taxpayer compliance with Treas. Reg. § 1.482-1(d)(3) notice requirement].

We conclude that while the taxpayer may not be ultimately precluded from presenting setoff evidence in the event of litigation, we have a legal basis for the refusing to take it into consideration administratively if the notice and evidentiary provisions are not met. It is also quite possible that a court might interpret the regulations so as to refuse to consider the merits of a 482 setoff where timely notice and proof have not been provided.

With respect to [REDACTED]'s "new argument" contending that an arrangement existed for reimbursement - we do not agree.

No arrangement within the meaning of Treas. Reg. Section 1.482-1(d)(3) and Rev. Proc. 70-8 existed with respect to the [REDACTED] setoffs. Taxpayers self-serving letters of [REDACTED] and

██████████ arguably established the existence of an arrangement with respect to the \$██████████ offset for ██████████ but did not do so with respect to the ██████████ excess offsets.

We interpret the requirement of the existence of an arrangement during the taxable year under consideration (emphasis added) to require the existence of an arrangement during the FYE ██████████. No such arrangement was apparently even contemplated for FYE ██████████ because the taxpayer advances the ██████████ letters as the first evidence of such an arrangement.

Accordingly, we believe it appropriate to deny ██████████'s position that they be allowed to carry forward in excess of \$██████████ of excess offsets from FYE ██████████ to ██████████.

cc: ██████████

District Counsel, ██████████
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